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Houston: Bull Market in Bayou City | January 2013

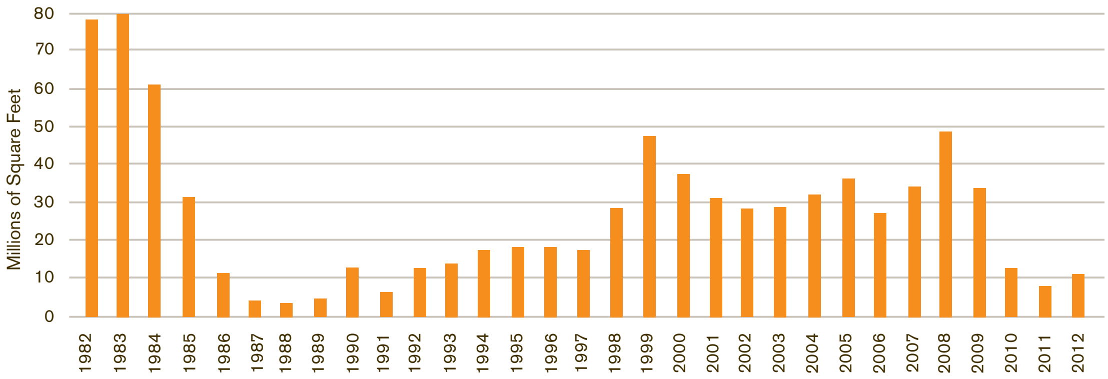
In December, consumers overcame news on the fiscal cliff to get some Christmas shopping done. ShopperTrak estimates November to December retail sales to rise 4.1% over the same period last year, with spending totaling $580 billion. The markets behaved similarly, shaking off frustration in DC to boost the S&P 500 by 0.9% for the month, and bringing the final 2012 total return number to +16.0%. In comparison, the MSCI US REIT Index (RMS) produced a total return of +17.8% for the year, aided by a +3.7% return in December. Sometimes the anticipation of a Christmas gift is enough to create positive enthusiasm. Though outsiders may not know it from weather reports and pictures of Houstonians in shorts, it has been Christmas in Houston all year for many businesses in 2012.

Houston's Overbuilding (and Underbuilding?)
A market that traditionally has risen and fallen with the price of oil and gas, Houston is best known in the real estate business for overbuilding in the 1980's. For example, in 1982 and 1983 combined, over 50 million square feet of office space was built, followed by another 23 million square feet in the next three years. 73 million square feet in five years! What outsiders may not know is that lenders and builders learned their lesson. From 1987 to 2011, only 70 million more square feet was added, an average of 2.8 million square feet per year. Despite a gradual rise in population, wages, and consumer spending, there has been below average building of new office, retail, and multifamily product in Houston in the past 25 years.

It's About the Jobs
Houston's economy was buoyed by the energy and commodity markets through the recession, making it easily the first market to regain all of the jobs it lost in 2008-2009. In fact, Houston now has 100,000 more people employed than it did at the peak prior to the recession. As of October 2012, Houston is one of only three of the top twenty major metro areas to recoup all jobs lost in the recession. The other two are Washington, DC and Dallas, TX. In the twelve months preceding October 2012, Houston added 95,800 jobs, second only to New York City with 127,900. However, as percentage, Houston added 3.7% to total

> *"...Houston added 3.7% to total employment in the past twelve months, which is more than any of the top twenty metro areas."*

FIGURE 1: HOUSTON MSA COMMERCIAL REAL ESTATE DELIVERED (MSF)



SOURCE: COSTAR, PPR, STIFEL NICOLAS, REIS, KEYBANC
NOTE: TOTAL DELIVERIES INCLUDES ONLY RETAIL, APARTMENT, OFFICE, AND INDUSTRIAL PROPERTIES. APARTMENT UNIT CONVERSION RATIO: 1 UNIT = 1000 SQFT

employment in the past twelve months, which is more than any of the top twenty metro areas. Unemployment in Houston was 6.2% in October, versus 7.5% for the nation. Looking into 2013, a ManpowerGroup survey indicated that 19% of Houston area companies plan to hire between January and March.

Energy and…?

Houston is an increasingly diverse city that is benefitting from business-friendly policies, low cost of living, and expansion of other businesses to support the growing population. Energy-sensitive employment comprised 49.7% of the total employment in Houston by the end of 2010 according to the Houston Institute for Regional Forecasting, down from 77.4% in 1986. The Port of Houston is consistently ranked first in the United States in foreign waterborne tonnage, first in US imports, second in the US in total tonnage, and thirteenth in the world by total tonnage. Additionally, the $5.25 billion widening of the Panama Canal by 2015 will require additional infrastructure to accommodate larger ships, which will drive exports and imports higher according to the Panama Canal Stakeholder Working Group. The Houston Airport System is the sixth busiest in the country, serving 50.4 million passengers in the twelve months ending October 31, 2012, which was up almost 1% over the preceding year. The Texas Medical Center is the largest medical center in the world with 93,500 employees occupying 31 million square feet. It contributes $14 billion per year to the Houston economy serving over 7 million patients in 2011.

Impact on Real Estate

According to Forbes and METRO, Houston is projected to have the highest population growth for the next five years by absolute numbers. It is projected to add the second-most jobs over the same period, trailing only New York City, which has almost three times the population of Houston. The Urban Land Institute (ULI) and PricewaterhouseCoopers (PwC) ranked Houston as a top 5 city to watch in for real estate in their annual 2013 Emerging Trends in Real Estate based on investment, development, and homebuilding. Given that real estate closely linked to economic growth, it stands to reason that the positive economic trends will benefit local commercial real estate.

Houston's industrial vacancy rates have dropped from 5.9% as of September 30, 2011 to 5.2% on September 30, 2012. The national vacancy rate for the same date measured over 8%. The decline in vacancy has helped to drive rental rate growth over the same period by over 10%. There are currently 56 industrial projects totaling 3.8 million square feet under construction, which equates to 0.8% of the total Houston industrial real estate inventory.

As of September 30, Houston's office vacancy stood at 11.9%, which was down from 13.4% last year at the same time. In comparison, the national office vacancy as of September 30, 2012 was over 14.0%. Despite the gradual increases in employment and population in Houston, there had been very little product built over the past 10 years. From 2000 to 2011, Houston averaged a 0.9% annual increase in office space, while the average annual employment increase was 1.4%. As such, Houston is now playing catch-up with new construction to accommodate businesses. There is 3.9 million square feet of new office product under construction currently, which equates to 1.9% of the total Houston office inventory.

The vacancy rate for Houston retail real estate was 7.2% as of September 2012, which was down from 7.6% last year. The national vacancy rate for retail space was 10.4% for the same date. The influx of jobs and people to the area has driven a significant increase in consumer spending versus last year. In the year to date period ending October 2012, Houston's sales tax payments totaled $471.7 million, which was 12.4% higher than the same period last year. Accordingly, the pipeline for retail development has increased to 1.1 million sqft; however, this number is only 0.4% of the total retail real estate in Houston. Notably, Tanger Outlets Texas City opened in October to impressive fanfare. The project is a 50/50 joint venture between Simon Property Group (NYSE: SPG) and Tanger Factory Outlets (NYSE: SKT).

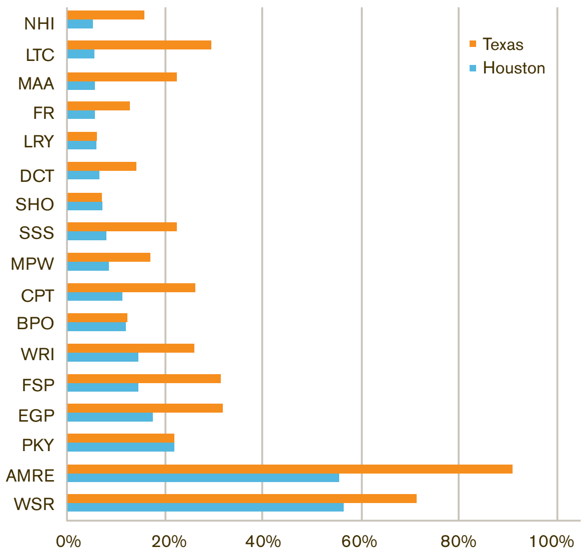
As of the end of October, Houston's apartment occupancy was 93.1% versus 91.5% the previous year, which drove a 7.1% year over year increase in rental rates. The market still has product to absorb in comparison to the rest of the country, which boasts occupancy of 94.5% as of the same date. According to Axiometrics, Houston had the highest increase in revenue per available unit (occupancy plus rental rate gains) of the top 20 apartment markets in October 2012 versus October 2011, posting a +9% increase.

How to Invest in Houston Commercial Real Estate

Being based out of Houston, we have been able to witness the growing prosperity across all property types firsthand. Accordingly, we have been steadily increasing our composite portfolio weighting to Houston up to its November 30 status of 5.1%. This compares to a 1.5% allocation to Houston in the MSCI US REIT Index. We believe that the superior job and population growth will continue to attract capital and investment which will drive up occupancy, rent, and values more than some of the traditional gateway cities over the next 5 years. Figure 2 shows REITs with significant exposure (>5%) to Houston. San Antonio, Austin, and Dallas are experiencing similar positive trends and, as a result, the Chilton REIT composite is overweight Texas with a 12.3% allocation versus 7.2% for the MSCI US REIT Index as of November 30. Below are company summaries with significant allocations to Houston in their portfolio. Data below is as of December 19 according to SNL Financial.

Whitestone REIT (NYSE: WSR) - Price $13.80; Dividend yield of 8.3%; Market capitalization $233 million. Approximately 56% of the portfolio, as measured by square feet of leasable area, is located in Houston. WSR's Houston portfolio is diversified by property type led by suburban office/flex totaling 1.2 million square feet, community shopping centers of 0.9 million square feet and pure suburban office of 0.2 million square feet. WSR has a unique investment strategy by targeting culturally diverse neighborhoods primarily in Houston and Phoenix.

FIGURE 2: EQUITY REITS WITH >5% OF PORTFOLIO SQUARE FEET IN HOUSTON MSA & TEXAS



SOURCE: SNL DATA AS OF 12/19/2012
NOTE: CONVERSION RATIO AS FOLLOWS: 1 APT UNIT = 1000 SQFT; 1 STORAGE UNIT = 150 SQFT; 1 LODGING ROOM = 500 SQFT; 1 HEALTH CARE BED = 500 SQFT

AmREIT (NYSE: AMRE) - Price $16.61; Dividend yield 4.8%; Market capitalization $268 million. Almost 60% of the portfolio is comprised of shopping centers located in Houston, with Texas (non-Houston) comprising an additional 29%. Uptown Park is considered one of their trophy properties in Houston. The company strives to own the best assets and refers to them as "Irreplaceable Corners". It has the highest average household income (>$110,000) in a one mile radius of its properties of all shopping center REITs. Based upon the number of households within a 3 mile radius (>48,000), AMRE is second only to Federal Realty (NYSE: FRT). Overall, the portfolio was 96.8% leased as of September 30. The company also owns centers in Dallas, San Antonio, and Atlanta. The company became publicly traded on July 26, 2012.

Weingarten Realty (NYSE: WRI) – Price $27.09; Dividend yield 4.3%; Market capitalization $3.3 billion. About 17% of net operating income is sourced from shopping centers located in Houston, with an additional 10% from non-Houston cities in Texas. River Oaks Shopping Center, The Village Arcade, and the Centre at Post Oak are a few of their major Houston properties. WRI's portfolio is geographically dispersed nationwide and the company is now a pure shopping center REIT, having sold its entire industrial portfolio earlier this year. Occupancy stood at 93.9% as of September 30. The tenant roster is well-diversified considering the top ten tenants only equate to 14.3% of total revenue. Based upon net operating income, 70% of the portfolio is grocery store anchored. These 12 grocer tenants average sales per square foot of $513. Similar to AmREIT, WRI focuses on high barrier-to-entry trade areas. Recently, the company analyzed its tenant mix for vulnerability to competition from the internet and found 76% of its rent was internet resistant, 14% fell into potential risk, and 10% considered vulnerable.

Parkway Properties (NYSE: PKY) – Price $13.64; Dividend yield 3.3%; Market capitalization $560 million. PKY is a pure play on office buildings in major Sunbelt cities.

Houston accounts for 25% of portfolio square footage once adjustments are made for announced acquisitions including Phoenix Tower adjacent to Greenway Plaza in Houston. The company has undergone a major transformation over the past year under a new management team. Almost $1 billion in assets have been sold and replaced with higher quality assets. Management believes by attaining critical mass in select sub-markets with in cities that meet their growth profile that they can outperform. Early results are encouraging considering occupancy rates have improved from 83.9% to 89.6% in the past year. Austin was recently identified as a target market.

Camden Property Trust (NYSE: CPT) - Price $66.48; Dividend yield 3.4%; Market capitalization $5.6 billion. CPT owns 206 apartment communities containing almost 70,000 units including properties under development. Houston accounts for 11.3% of net operating income (NOI) and Texas (non-Houston) equals 10.1% of NOI. Notable apartment communities are located in the Greenway Plaza and West University areas. The largest market is Washington, DC with 17% of NOI followed by Tampa with 8.1% and Charlotte with 5.9%. 97% of its portfolio is located in US metro areas with the highest growth rates in employment and population. Houston leads in occupancy at almost 97% versus portfolio-wide occupancy of 95.3%. As of September 30, 2012, year to date same property NOI was third best among all apartment REITs at +9.5%.

Eastgroup Properties (NYSE: EGP) - Price $53.24; Dividend yield 4.0%. Market capitalization $1.6 billion. EGP is a pure play industrial REIT focused on business distribution and light manufacturing. Houston is their largest market with 5.1 million square feet representing 16.8% of the portfolio. Texas (non-Houston) accounts for an additional 14.1% of leasable area. The Houston portfolio is 98% leased versus 95.0% for the company as a whole. World Houston, located adjacent to Bush Intercontinental Airport, is their largest project with over 2.5 million square feet.

Chilton REIT Commitment to Research

Our unique position as a REIT manager in Houston has certainly helped us to recognize that Houston was, and continues to be, underappreciated by the market. Our local perspective that gave us an advantage proves that 'boots on the ground' experience and contact is the best way to stay ahead of the market. We strive to keep the same diligence with respect to other major geographic areas through property tours, conversations with locals, and frequent contact with REIT management teams, in addition to traditional quantitative research. In 2013 and beyond, we believe this commitment to fundamental research will give us the best opportunity to outperform the index, net of fees, while appropriately evaluating risk.

Sources: ShopperTrak, The CoStar Group, PPR, Stifel Nicolas, Newmark Grubb Knight Frank, Colliers International, The Greater Houston Partnership, The Institute for Regional Forecasting, Green Street Advisors, SNL Financial

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RMS: 1280(12.31.2012) vs. 1087 (12.31.2011) vs. 1000 (12.31.2010) vs. 792 (12.29.2009) vs. 933 (9.30.2008) and 1330 (2.7.2007)

Please feel free to forward this publication to interested parties and make introductions where appropriate.

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